

BAD FAITH AND PROs: PERKINS V. STATE FARM INS. CO.

BY: PLATTE B. MORING, III AND JASON W. HOBBS

On December 16, 2008, the United States District Court for the Middle District of Pennsylvania entered a decision allowing a bad faith claim to proceed for failure of an insurer to pay first party medical benefits. *Perkins v. State Farm Ins. Co.*, 589 F. Supp.2d 559 (M.D. Pa. 2008). The Honorable John E. Jones, III examined the “dissonant precedent” in Pennsylvania regarding the remedies offered by the Pennsylvania Personal Injury Protection statute, 75 Pa.C.S.A. § 1797, and the Pennsylvania Bad Faith statute, 42 Pa.C.S.A. § 8371. Judge Jones determined that the two statutes could be read in conjunction with one another, allowing bad faith claims for disputes over first party medical benefits, so long as there is an allegation that the insurer abused the peer review process.

Statutory Background

The Pennsylvania legislature has crafted two potential remedies for litigants who feel they were wrongfully denied first party medical benefits under an insurance policy. The first remedy is set forth in the Pennsylvania Motor Vehicle Financial Responsibility Law, and is known as the Pennsylvania Personal Injury Protection (PIP) statute. 75 Pa.C.S.A. § 1797. This statute sets forth the rights and responsibilities of insurers and insured parties with regard to first party medical benefits. In general, an insurer may challenge the “medical necessity” of certain treatment by submitting records of the treatment to a Peer Review Organization (PRO). If an insured party is denied benefits under a policy, the insured, or the medical provider, may challenge the PRO determination or file suit against the insurer. Should the court find that the treatment for which payment was denied was indeed medically necessary, the court can award the cost of treatment plus interest of 12 percent per year, costs, and attorneys’ fees (treble damages are available if the plaintiff can prove “wanton” conduct on the part of the insurer).

The second potential remedy is found in the Pennsylvania Bad Faith statute. 42 Pa.C.S.A. § 8371. The Bad Faith statute is significantly more general than the PIP statute. The Bad Faith statute provides a remedy to any insured party who feels their insurance company has acted in “bad faith.” The statute does not define “bad faith.” Rather, Pennsylvania case law has defined “bad faith” to be where an insurer denies benefits under a policy without a reasonable basis *and* the insurer knew or recklessly disregarded its lack of reasonable basis in denying the claim. *Terletsky v. Prudential Prop. & Cas. Ins. Co.*, 437 Pa. Super. 108, 125, 649 A.2d 680, 688 (1994). The remedy offered by the Bad Faith statute is interest at the prime rate plus 3 percent, costs, attorneys’ fees, and punitive damages.

Conflict Between the PIP Statute and the Bad Faith Statute

In practice, plaintiffs who feel their first party medical benefits claims have been wrongfully denied typically claim violations of both the PIP statute and the Bad Faith statute. This presents a problem to the court system as well as to the defendants. The remedies offered by the two statutes are distinctly different. They offer different interest rates, the PIP statute allows treble damages, and the Bad Faith statute allows punitive damages. Clearly, it makes little sense for a claim for denial of first party medical benefits to proceed under both statutes because the available remedies and applicable law are substantively different.

In an attempt to resolve this conflict, Pennsylvania courts and federal courts interpreting Pennsylvania law have developed a panoply of confusing decisions on the issue. Although the Pennsylvania Superior Court initially resolved this conflict in a 1993 decision holding that the PIP statute was the exclusive remedy for denial of first party medical benefits, the opinion

was unfortunately reversed on other grounds the following year. *Barnum v. State Farm Mutual Auto Insurance Co.*, 635 A.2d 155 (Pa. Super. 1993), *reversed on other grounds*, 652 A.2d 1319 (1994). This left unsettled the validity of the holding in *Barnum* regarding the PIP statute and the Bad Faith statute. Since *Barnum*, no Pennsylvania appellate court has considered the issue, although it has been addressed by several Third Circuit decisions and numerous state trial courts.

One of the most recent federal cases to analyze this statutory conflict is *Perkins*. In *Perkins*, Judge Jones engaged in a thorough review of the two statutes and of the case law expounding upon them. He acknowledged the importance of the holding in *Barnum*, but did not rely upon it. Instead, Judge Jones followed the reasoning of the district court decision of *Schwartz v. State Farm Ins. Co.*, 1996 WL 189839 (E.D. Pa. 1996). In *Schwartz*, the court found that both the PIP statute and the Bad Faith statute were applicable in certain cases. The *Schwartz* court held that a party could bring a bad faith claim for denial of first party medical benefits where the procedure for use of a PRO as set forth in the PIP statute was not properly followed.

Judge Jones followed the court in *Schwartz* and held that the “pivotal question . . . becomes whether [plaintiff’s] allegations fall within the purview of [the PIP statute], thus invoking the remedies established therein and precluding resort to [the Bad Faith statute].” The allegations of abuse of the PRO process in *Perkins* were based on the plaintiff’s theory that the insurer had used a biased PRO. The plaintiff alleged, among other things, that the PRO selected by the insurer had done substantial work for the insurer, and thereby had a substantial interest in continuing to provide biased determinations. The court in *Perkins* held that this allegation, although weak, was outside the scope of the PIP statute, and therefore the plaintiff could proceed with the bad faith claim.

This decision shows a growing trend of allowing claims for denial of first party medical benefits to proceed under both statutes, at least where the plaintiff alleges abuse of the PRO process. The holdings of

Schwartz, *Perkins*, and related cases still support the holding in *Barnum* to the extent it prohibits bad faith claims for denial of first party medical benefits where there are no allegations of PRO abuse. In other words, in order for a plaintiff to proceed on a bad faith claim and potentially obtain punitive damages, the plaintiff need only allege that the insurer improperly selected a PRO or improperly relied upon a PRO for causation. The holding of the court in *Perkins* illustrates the value of using an independent or “blind” PRO selection service. This will prevent prospective plaintiffs from effectively arguing that the PRO has a reason to provide a biased determination. Although the Pennsylvania Supreme Court has not ruled on this issue, the cases of *Schwartz* and *Perkins* show that Pennsylvania is currently headed towards a more expansive approach to bad faith claims for denial of first party medical benefits.

Platte Moring is a partner in the Litigation Department and Managing Partner of the Allentown office. **Jason Hobbes** is an associate in the Litigation Department. The authors’ practice focuses on commercial, insurance, and bad faith litigation. For more information on this case or other bad faith issues, contact Platte (610.782.4948; moringp@whiteandwilliams.com) or Jason (610.782.4955; hobbesj@whiteandwilliams.com).

This alert should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult a lawyer concerning your own situation with any specific legal question you may have.

© 2009 White and Williams LLP